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COMMONWEALTH OF VIRGINIA, *ex rel.*

MIKE DEANE, *et al.*

v.

CASE NO. PUE980059

BOTETOURT FOREST WATER CORPORATION

REPORT OF ALEXANDER F. SKIRPAN, JR., HEARING EXAMINER

January 8, 1999

On January 10, 1998, Botetourt Forest Water Corporation (“Botetourt Water” or “Company”) notified its customers of its intent to increase its rates for water service effective March 1, 1998, pursuant to the Small Water or Sewer Public Utility Act (“Small Water Act”).¹ The Company proposed to increase the monthly charge for the first 2,000 gallons from \$16.00 to \$17.00 and to increase the monthly price for each additional 1,000 gallons from \$5.00 to \$5.50. By February 18, 1998, approximately 26% of the Company’s customers had filed objections with the Commission.

On March 5, 1998, the Commission, pursuant to § 56-265.13:6 of the Virginia Code, issued a Preliminary Order declaring the proposed rates interim and subject to refund, with interest, as of March 5, 1998. On March 18, 1998, the Commission entered an Order for Notice and Hearing in which it directed the Company to provide public notice, established a procedural schedule, assigned the matter to a Hearing Examiner, and scheduled the matter for public hearing on September 15, 1998.

The evidentiary hearing on the proposed tariff revisions was held in Richmond on September 15, 1998. Counsel appearing were: Kenworth E. Lion, Jr., Esquire, counsel to Botetourt Water; and Allison L. Held, Esquire, and Marta B. Curtis, Esquire, counsel for the Commission’s Staff. Filed with this Report is a transcript of the hearing. Proof of public notice was marked as Exhibit Company-1 and admitted into the record. Botetourt Water and Staff filed limited briefs on October 16, 1998.

SUMMARY OF THE RECORD

Botetourt Water provides water service to residences of two housing subdivisions, Botetourt Forest and Heatherstone, and to the Blue Ridge Mall in Blue Ridge, Virginia.² As of December 31, 1997, the end of the test period in this case, the Company served 121 customers through two separate water distribution systems that are approximately twenty-two years old.³

¹ Virginia Code § 56-265.13:1, *et seq.*

² Exhibit JBB-S-3, at 2.

³ *Id.*; Exhibit GLA-6, at 1-2.

Mr. Jerry B. Bowen, the Company's original builder, continues to own and operate Botetourt Water. Mr. Bowen also was the principal developer and builder of the residential properties served by Botetourt Water.⁴

On June 11, 1998, the Company filed the direct testimony of Mr. Bowen.⁵ According to Mr. Bowen, since 1992, Botetourt Water's operating expenses have increased from \$26,323 to \$62,773. Mr. Bowen attributes most of this increase to the fact that in 1992 Mr. Bowen and his construction company provided many services to the utility at no charge.⁶ Unlike 1992, test year expenses now include utility employee salaries and retirement benefit expenses.⁷ Despite rate increases in 1994 and 1996, Mr. Bowen still does not charge Botetourt Water for office space or vehicle expenses, and made a personal loan of \$13,000 to the Company during the test year.⁸ Consequently, Mr. Bowen claims that "[t]he 1997 test year expenses experienced by the company more than justify the proposed increase in rates."⁹

On August 28, 1998, Staff filed the testimony of John B. Barker, a public utility accountant with the Division of Public Utility Accounting¹⁰ and Gregory L. Abbott, a utilities specialist in the Division of Energy Regulation.¹¹ Generally, Staff recommends that Botetourt Water reduce its rates to decrease annual revenues by \$3,500, and return \$8,970 of connection fees the Company lacked authority to impose.¹²

Based on the results of Staff's audit, Mr. Barker adjusted the financial results of Botetourt Water for the test year ending December 31, 1997 as follows:¹³

	<u>Per Books</u>	<u>Staff Adjustments</u>	<u>Staff Adjusted</u>
Operating Revenues	\$46,334	\$2,170	\$48,504
Operating Expenses	\$62,773	(\$24,324)	\$38,449
Operating Income (Loss)	(\$16,439)	\$26,494	\$10,055
Rate Base	\$10,175	\$25,396	\$35,571
Rate of Return on Rate Base	-161.56%		28.27%

⁴ Exhibit JBB-S-3, at 2; Exhibit JBB-C-7, at 7-8.

⁵ Exhibit JBB-C-2.

⁶ *Id.* at 1.

⁷ *Id.*

⁸ *Id.*

⁹ *Id.* at 2.

¹⁰ Exhibit JBB-S-3.

¹¹ Exhibit GLA-6.

¹² Exhibit JBBS-3, at 21; Exhibit GLA-6, at 6.

¹³ Exhibit JBB-S-4, at Statement I – Revised 9/15/98.

Salaries and wages account for most of the difference between the Company and the Staff. Botetourt Water seeks the recognition of \$46,200 in salary expense consisting of \$18,000 for its president, Mr. Bowen; \$24,000 for its office manager, Mrs. Bowen; and \$4,200 for its meter reader.¹⁴ Staff witness Barker reviewed the duties, estimated hours worked, and the proposed hourly wage for each employee.¹⁵ Mr. Barker reduced estimates for hours worked to reflect that Mr. and Mrs. Bowen spend four months each year in Florida.¹⁶ Furthermore, Mr. Barker compared his analysis of employee duties and costs for Botetourt Water with another small water company, Pelham Manor Water Supply Company (“Pelham Manor”).¹⁷ Based on this review, Mr. Barker recommends a total salary expense of \$20,140, composed of \$11,232 for Mr. Bowen, \$4,708 for Mrs. Bowen, and \$4,200 for the meter reader.¹⁸

On the other hand, Staff witness Barker increased operating expenses to include several items not included in the Company’s test year results. Included in Staff’s operating expenses are: (i) \$350 for rate case expense, which represents a two-year amortization of total estimated rate case costs of \$700;¹⁹ (ii) \$2,700 for office rent expense;²⁰ (iii) \$500 for equipment rental expense;²¹ and \$383 for mileage expense.²² Nonetheless, even with the inclusion of these additional expenses, Mr. Barker finds that the Company’s current rates are excessive and should be reduced by \$3,500.²³

Staff witness Abbott presents an alternative rate design that incorporates Staff’s recommended revenue reduction. Specifically, Mr. Abbott recommends that the Commission maintain the minimum charge and allocate any decrease to the incremental usage charge.²⁴ Shown below is a comparison of Botetourt Water’s current rates, its proposed rates, and Staff’s proposed rates:²⁵

	<u>Current Rates</u>	<u>Company’s Proposed Rates</u>	<u>Staff’s Proposed Rates</u>
First 2,000 gallons	\$16.00	\$17.00	\$16.00
Each Additional 1,000 gallons	\$5.00	\$5.50	\$4.35

¹⁴ Exhibit JBB-S-3, at 9.

¹⁵ *Id.* at 9-12.

¹⁶ *Id.*

¹⁷ *Id.*

¹⁸ *Id.* at 11.

¹⁹ *Id.* at 7-8.

²⁰ *Id.* at 12.

²¹ *Id.*

²² *Id.* at 13.

²³ *Id.* at 21.

²⁴ Exhibit GLA-6, at 4.

²⁵ *Id.* at 3-4.

In addition, during its review for this case, Staff discovered that Botetourt Water has been charging a connection fee of \$500 since 1994.²⁶ The Company's current approved tariff does not provide for the collection of connection fees.²⁷ Moreover, in 1997 the Company collected connection fees of \$1,000 from each of two customers located outside its certificated service territory.²⁸ Consequently, Mr. Abbott recommends that the Commission order Botetourt Water to cease charging a connection fee and refund the \$8,970 of connection fees collected through 1997, along with connection fees collected during 1998.²⁹ Mr. Abbott also recommends that the Company be required to file an application to amend its certificate of public convenience and necessity to expand its service territory to include all customers it currently serves.³⁰

On September 9, 1998, Botetourt Water filed the prepared rebuttal testimony of Jerry B. Bowen.³¹ Mr. Bowen disagreed with Staff's adjustments related to salary expense, office rent expense, equipment rental expense, mileage expense and rate case expense, and proposes a new adjustment to include health insurance in utility expenses.³² Mr. Bowen also addresses issues raised by Staff regarding connection fees.³³

Mr. Bowen maintains that his estimated minimum number of hours worked each month should not be reduced during the months he is in Florida. Mr. Bowen testifies that he continues most of his duties while in Florida and that the estimate provided to Staff represented the minimum number of hours worked per month.³⁴ Furthermore, Mr. Bowen argues that Staff's use of Pelham Manor as a measure of hourly labor costs for small water utilities "is arbitrary and inappropriate."³⁵ Mr. Bowen suggests that if such comparisons are made, companies such as Lundie Utilities, Inc.; Williamsburg Court Water Company; and Long Hollow Water Development Co. would provide a more meaningful measure.³⁶ Finally, Mr. Bowen makes similar arguments regarding the office manager's salary and contends that Staff neglects to consider that his wife is on call twenty-four hours a day, 365 days a year.³⁷

As to the other expense adjustments in dispute, Mr. Bowen generally argues that the Staff fails to ascribe adequate levels of activity to Botetourt Water. For example, Mr. Bowen believes that Staff should have assigned 90%, rather than 50%, of the estimated cost of office space to the Company.³⁸ Mr. Bowen also estimates backhoe usage at fifty-two times a year rather than Staff's

²⁶ *Id.* at 5.

²⁷ *Id.*

²⁸ *Id.*

²⁹ *Id.* at 6.

³⁰ *Id.* at 7.

³¹ Exhibit JBB-C-7.

³² *Id.* at 1-7, 9.

³³ *Id.* at 7-8.

³⁴ *Id.* at 2-3.

³⁵ *Id.* at 3.

³⁶ *Id.*

³⁷ *Id.* at 4.

³⁸ *Id.* at 5.

estimated usage of two, and mileage to be 10,260 miles rather than 1,235.5 miles as estimated by Staff.³⁹ Regarding rate case expense, the Company now estimates professional fees for this case to be \$2,700, up from its preliminary estimate of \$700 incorporated into Staff's adjustment.⁴⁰ Lastly, Mr. Bowen requests that fifty percent of health insurance premiums paid for himself and his wife be included in Botetourt Water's test year expenses.⁴¹

Regarding connection fees, Mr. Bowen explains that until 1994, his construction company built all of the homes served by Botetourt Water and did not charge the Company the cost of making connections.⁴² When other builders began constructing homes, Botetourt Water instituted a connection fee of \$500 plus actual cost, if any, over \$500.⁴³ During 1997, Botetourt Water connected two customers located outside its service territory and charged each new customer \$1,000 for connection to the system.⁴⁴ Mr. Bowen supports these charges by itemizing costs incurred to connect both customers.⁴⁵

During the hearing, Staff witness Barker accepted the Company's new estimate for the cost of the rate case, but revised his recommended amortization period from two years to three years.⁴⁶ In addition, Staff introduced an exhibit comparing the revenues and wages of twelve water companies comparable to Botetourt Water as further support for its recommendation in this case.⁴⁷ The table shown below summarizes the revenue and payroll of the water utilities analyzed by Staff.

<u>Company</u>	<u>Revenues</u>	<u>Total Salary and Wages</u>⁴⁸
<i>Botetourt Water (Per Staff)</i>	\$48,504	\$21,160
Long Hollow Water Company	\$48,253	\$14,248
Lundie Utilities, Inc.	\$61,125	\$29,228
Williamsburg Court	\$44,514	\$24,456
Blue Ridge Utility	\$52,456	\$28,500
Highland Lakes	\$42,924	\$19,825
Tinkerview	\$58,417	\$25,059
Valley Ridge	\$54,551	\$18,950
Commonwealth	\$32,453	\$19,037
Daleville	\$31,783	\$20,530
Heritage Homes of VA	\$59,816	\$22,113

³⁹ *Id.* at 5-7.

⁴⁰ *Id.* at 7.

⁴¹ *Id.* at 9.

⁴² *Id.* at 7.

⁴³ *Id.* at 7-8.

⁴⁴ *Id.* at 8.

⁴⁵ *Id.* at Attachment B.

⁴⁶ Barker, Tr. at 22.

⁴⁷ Exhibit JBB-S-5.

⁴⁸ The sum of Employee Salaries, Officer Salaries, and Related Contractual Services shown on Exhibit JBB-S-5.

Aubon	\$35,484	\$16,213
Peacock Hill	\$63,124	\$23,519
Average (excluding Botetourt)	\$48,742	\$21,807

DISCUSSION

The Small Water Act requires the charges of utilities, such as Botetourt Water, to be: (i) uniform as to all persons served under like conditions; and (ii) nondiscriminatory, reasonable, and just.⁴⁹ Virginia Code § 56-265.13:4 further defines reasonable and just charges to be:

the lowest charges as shall produce sufficient revenues to pay all lawful and necessary expenses incident to:

1. The operation of the system, including maintenance costs, operating charges, and interest charges . . . ;
2. The providing for the liquidation of bonds . . . and the attraction of capital;
3. The providing of adequate funds to be used as working capital . . . ;
4. The providing for the payment of taxes . . . ; and
5. Compensation of owners of the utility for their capital or property invested in the system, if any, and for their time and other resources expended in the operation of the system

In this case, there are six issues related to the level of lawful and necessary expenses which, in turn, are used to measure the sufficiency of revenues. Each of these issues will be addressed separately below. Issues concerning connection fees will be considered following the discussion of expense related issues.

Lawful and Necessary Expenses

1. Salaries and Wages

As described above, the issue with the greatest impact on the ultimate rates to be set in this case concerns the determination of salaries and wages. Specifically, Mr. and Mrs. Bowen seek wages of \$18,000 and \$24,000, respectively.⁵⁰ Staff, on the other hand, recommends a salary of \$11,232 for Mr. Bowen and a salary of \$4,708 for Mrs. Bowen.⁵¹

⁴⁹ Va. Code § 56-265.13:4.

⁵⁰ Exhibit JBB-S-3, at 9.

⁵¹ *Id.* at Appendix A, page 14.

During the test year ended December 31, 1997, Mr. Bowen received a monthly salary of \$1,500 per month during only nine of the twelve months for a total annual salary of \$13,500.⁵² Mr. Bowen seeks rates designed to provide him with \$1,500 per month for twelve months.⁵³ Mr. Bowen further estimates that the duties he undertook on behalf of Botetourt Water required, at a minimum, about fifty hours per month.⁵⁴ Mr. Bowen justified Mrs. Bowen's annual salary based on estimates that she spends fifty-one hours per month on Botetourt Water related activities and is on call twenty-four hours per day.⁵⁵

To derive its recommended annual salary for Mr. Bowen of \$11,232, Staff multiplied its estimate of his annual hours worked, 432 hours, by its prescribed hourly rate of \$26 per hour.⁵⁶ Staff witness Barker reviewed the list of duties and times provided by Mr. Bowen and concluded that Mr. Bowen devoted fifty hours per month to Botetourt Water for the eight months of the year Mr. Bowen lived in Virginia and eight hours per month during the four months Mr. Bowen lived in Florida.⁵⁷ Staff based its recommended hourly rate of \$26 per hour for Mr. Bowen on a similar Staff proposal in Case No. PUE960129 regarding Pelham Manor.⁵⁸

Staff determined its proposed annual salary for Mrs. Bowen of \$4,708 based on an estimated number of hours worked of 408 and an hourly rate of \$11.54 per hour.⁵⁹ Staff witness Barker arrived at his annual estimate of 408 hours for Mrs. Bowen by multiplying the fifty-one hours per month contained in Botetourt Water's analysis of Mrs. Bowen's duties by eight, or the number of months the Bowens lived in Virginia.⁶⁰ Mr. Barker testified that Mrs. Bowen could not conduct any of her duties from Florida.⁶¹ Staff arrived at its hourly rate of \$11.54 for Mrs. Bowen by dividing her proposed annual salary of \$24,000 by the normal number of work hours in a year or 2,080 hours.⁶²

A determination of an appropriate level of salaries and wages for Mr. and Mrs. Bowen turns on three issues. These issues are: (i) whether or to what extent the Bowens are entitled to compensation for being on call twenty-four hours a day; (ii) establishing the appropriate number of hours the Bowens devote to operating Botetourt Water; and (iii) ascertaining a fair rate of compensation for the services provided by the Bowens.

Compensation for being on call

⁵² *Id.* at 10, Appendix A, page 14.

⁵³ Exhibit JBB-C-7, at 1.

⁵⁴ *Id.* at 2.

⁵⁵ *Id.* at 4.

⁵⁶ Exhibit JBB-S-3, at 10-11.

⁵⁷ *Id.*

⁵⁸ *Id.*

⁵⁹ *Id.* at 11.

⁶⁰ *Id.*

⁶¹ *Id.*

⁶² *Id.*

Botetourt Water justifies most of Mrs. Bowen's \$24,000 salary to the fact that she is on call twenty-four hours a day. Virginia Code § 56-265.13:4 provides for compensation to the owners of small water utilities for their time and other resources invested or expended in the operation of a utility. Thus, compensation for the Bowens should be a function of the value of the time they actually devote to Botetourt Water. Being on call should not be added to the number of hours actually devoted to utility operations. Instead, in this case it is more appropriate to factor being on call into hourly payroll rates.

Number of hours

In accordance with the Rules Implementing the Small Water or Sewer Public Utility Act, Botetourt Water bears the burden of proof regarding any changes in its tariffs.⁶³ Therefore, Botetourt Water bears the burden of producing evidence to establish the time Mr. and Mrs. Bowen actually devote to the utility.

In this case, Botetourt Water offered an analysis for each employee of duties performed each month and estimates of the time required to perform each duty listed.⁶⁴ Staff accepted Botetourt Water's monthly estimates for Mr. and Mrs. Bowen for eight months of the test year. However, during the four months the Bowens were in Florida, Staff reduced Mr. Bowen's monthly hours from fifty to eight, and Mrs. Bowen's monthly hours from fifty-one to zero.⁶⁵ However, Botetourt Water continues to argue that Mr. and Mrs. Bowen's monthly hours should not be reduced when they are in Florida.⁶⁶

Mr. Bowen claims that his monthly time estimates represent the minimum number of hours he devotes to Botetourt Water, including months that he is in Florida.⁶⁷ Furthermore, Mr. Bowen testified that when in Florida, he returned to Virginia once or twice a month to take care of utility business.⁶⁸ Nonetheless, during the hearing Mr. Bowen was unable to recall specifically when he returned to Virginia.⁶⁹ As to Mrs. Bowen, during cross-examination Mr. Bowen admitted that while in Florida Mrs. Bowen did not make daily checks of pump house circuit breakers.⁷⁰ Such activities accounted for thirty of her estimated fifty-one monthly hours.⁷¹ Therefore, I find that Botetourt Water failed to meet its burden of proof regarding the time the Bowens devote to Botetourt Water while they are in Florida.

On the other hand, Staff appears to underestimate the hours of service provided by the Bowens during their four months in Florida. Staff witness Barker was unaware of the fact that

⁶³ 20 VAC 5-200-40.

⁶⁴ Exhibit JBB-S-3, Appendix A, at 15-18.

⁶⁵ Exhibit JBB-S-3, at 10-11.

⁶⁶ Lion, Tr. at 100.

⁶⁷ Exhibit JBB-C-7, at 2.

⁶⁸ *Id.*

⁶⁹ Bowen, Tr. at 82.

⁷⁰ *Id.* at 84.

⁷¹ Exhibit JBB-S-3, Appendix A, at 17.

Mr. Bowen returned from Florida as needed.⁷² Further, Mr. Bowen testified that Mrs. Bowen, while in Florida, was able to field customer complaints and act as a liaison between workers repairing lines and customers complaining of no water.⁷³ Consequently, I find that the record supports a slightly higher number of hours than those utilized by Staff in calculating its adjustment.

During the test year, Botetourt Water paid Mr. Bowen his full monthly salary for nine of the twelve months. Because Mr. Bowen lived in Virginia for only eight months during this period, in essence, the Company paid Mr. Bowen for one month, or a total of 50 hours during the period he was in Florida. Payment for 50 hours works out to 12.5 hours per month, for the four months he lived in Florida. Use of 12.5 hours per month for Mr. Bowen for the four months he lived in Florida rather than Staff's proposed eight hours per month provides further allowance for Mr. Bowen's return trips from Florida. Thus, Mr. Bowen's salary expense in this case should be based on 450 hours.

Furthermore, based on Mr. Bowen's testimony, Mrs. Bowen appears to have continued some of her duties, by telephone, while living in Florida. Therefore, I find that the record in this case supports the inclusion of six hours per month, or about half of the time credited to Mr. Bowen, for the four months during which Mrs. Bowen lived in Florida. Inclusion of an additional twenty-four hours⁷⁴ increases the total annual hours worked by Mrs. Bowen from 408, as proposed by the Staff, to 432.

Hourly payroll rates

As discussed above, Staff determined Mrs. Bowen's hourly payroll rate of \$11.54 per hour by dividing her annual test year salary of \$24,000 by the number of full time hours in a year or 2,080. A similar calculation for Mr. Bowen based on his monthly test year salary of \$1,500 divided by fifty hours per month produces an hourly salary for Mr. Bowen of \$30.00 per hour. Staff, however, recommends that Mr. Bowen's hourly wage be reduced to \$26.00 per hour based on a recommendation made by the Staff in another case. While wage rate comparisons can provide a valid means of establishing the value of service provided by a utility employee, other factors, such as the experience of the employee and the quality of service provided also should be considered. The record in this case shows that Mr. Bowen has operated Botetourt Water for twenty-two years and is the only utility employee qualified to use a backhoe.⁷⁵ In addition, Mr. Bowen is on call twenty-four hours a day and appeared to be committed to providing customers with reliable service.⁷⁶ Accordingly, I find that Mr. Bowen's test year hourly wage rate of \$30.00 per hour is appropriate for determining salary expenses in this case.

Staff's proposed hourly rate for Mrs. Bowen should be adopted without adjustment. Staff started with the total annual salary recommended by Botetourt Water of \$24,000. Thus, any premium required to compensate for being on call twenty-four hours a day is already included in

⁷² Barker, Tr. at 35-37.

⁷³ Bowen, Tr. at 85-86.

⁷⁴ Six hours per month times four months.

⁷⁵ Bowen, Tr. at 91; Exhibit JBB-C-7, at 3.

⁷⁶ See, e.g., Bowen, Tr. at 72-74, 93-94; Exhibit JBB-C-7, at 9.

the Staff's hourly rate. Therefore, I find that Mrs. Bowen's test year hourly wage rate of \$11.54 per hour is appropriate for determining salary expenses in this case.

In summary, based upon the findings discussed above, Botetourt Water's revenue requirement in this case should include salaries for Mr. and Mrs. Bowen of \$13,500 and \$4,985, respectively. These salaries, plus the meter reader's salary of \$4,200, produce a total pro forma salary and wage expense of \$22,685.⁷⁷

2. Office Rent Expense

Mr. and Mrs. Bowen operate Botetourt Water from a 30' by 18' office in their home.⁷⁸ The Bowens also use the office to operate two other businesses, a construction company and real estate sales company, and for personal use.⁷⁹ During the test year, Botetourt Water did not record an expense for office rent.⁸⁰ Nonetheless, Staff witness Barker proposed an adjustment to increase operating expenses to include an annual rent expense of \$2,700.⁸¹ Mr. Barker found the cost of comparable office space to be \$10 per square foot.⁸² Because the Bowens used the office for other purposes, Mr. Barker assigned 50% of the total annual rent expense to Botetourt Water.⁸³

On rebuttal, Company witness Bowen argued that based on his estimate of usage, 90% of the total annual rent expense should be assigned to Botetourt Water.⁸⁴ Mr. Bowen explains that his construction company has been inactive since 1995 and remains in existence solely to conduct corrective work on homes built prior to that date.⁸⁵ Similarly, Mr. Bowen states that his real estate sales company exists solely to hold title to real property.⁸⁶

During the hearing Staff witness Barker further justified Staff's assignment of 50% of the annual rent expense to Botetourt Water by questioning the need for an office that is

⁷⁷ For complete consistency with the chart based on Exhibit JBB-S-5 shown on page 5 of this Report, an additional \$1,020 of related contractual services should be added to Botetourt Water's total pro forma salaries and wages. This new total of \$23,705 falls within the range of results from the other companies, with four of the twelve other companies continuing to have higher totals.

⁷⁸ Exhibit JBB-S-3, at 12.

⁷⁹ Exhibit JBB-C-7, at 5.

⁸⁰ Exhibit JBB-S-3, at 12.

⁸¹ *Id.*

⁸² *Id.*

⁸³ *Id.*

⁸⁴ Exhibit JBB-C-7, at 5.

⁸⁵ *Id.*

⁸⁶ *Id.*

approximately 5,400 square feet.⁸⁷ In Mr. Barker's opinion, Botetourt Water does not need an office the size of the one located in the Bowen's home.⁸⁸

As discussed above, Botetourt Water bears the burden of proving the reasonableness of its requested rent expense. In this case, Botetourt Water's requested rent expense only materialized on rebuttal and is supported solely by Mr. Bowen's estimate of usage. No other evidence such as the space devoted to files or supplies or otherwise required by operations has been offered by the utility. Therefore, I find Staff's recommendation to be reasonable and more consistent with the record in this case.

3. Equipment Rental Expense

As with office expense, Botetourt Water did not include any expense for the use of a backhoe or a pressure washer owned by Mr. Bowen.⁸⁹ Staff found that a comparable backhoe and pressure washer rent for \$215 and \$72 per day, respectively.⁹⁰ Based on this information, Staff added \$500 to test year operating expenses to reflect approximately two days' use for the backhoe and one day's use for the pressure washer.⁹¹

In his rebuttal testimony and during the hearing, Mr. Bowen argued that the backhoe was used fifty-two times during the test year.⁹² Accordingly, Mr. Bowen asserts that Staff's adjustment for backhoe usage should be increased to \$11,252.⁹³

Staff witness Barker disagrees. Mr. Barker points out that the total cost of a comparable used backhoe is between \$9,000 and \$10,000.⁹⁴ Mr. Barker contends that Staff's proposed adjustment provides a more reasonable allocation of cost to Botetourt Water for use of the backhoe.⁹⁵ Mr. Barker also criticized Botetourt Water for failing to maintain a backhoe usage log that would permit more precision in apportioning the cost of the backhoe to Botetourt Water and between capital and maintenance projects.⁹⁶ In addition, Mr. Barker opined that Botetourt Water utilized the backhoe when other less costly tools (*i.e.*, a shovel and wheelbarrow) could have been employed.⁹⁷

Ideally, a portion of the annual depreciation cost of the backhoe should be assigned to Botetourt Water based on the percentage of time the backhoe legitimately is used by Botetourt

⁸⁷ Barker, Tr. at 47.

⁸⁸ *Id.*

⁸⁹ Exhibit JBB-S-3, at 12.

⁹⁰ *Id.*

⁹¹ *Id.*

⁹² Exhibit JBB-C-7, at 6; Bowen, Tr. at 87.

⁹³ Exhibit JBB-C-7, at 6.

⁹⁴ Barker, Tr. at 27.

⁹⁵ *Id.*

⁹⁶ *Id.* at 28-29.

⁹⁷ *Id.* at 29.

Water. Backhoe usage records also should be used to apportion total backhoe costs assigned to Botetourt Water between capital and expense accounts. Finally, backhoe related costs assigned to Botetourt Water should be compared to the market value, or fair rental value, of the backhoe for the number of hours or days the backhoe actually is used by the Company.

For example, if a comparable backhoe costs \$10,000 and is depreciated over a five-year period, total annual depreciation would be \$2,000.⁹⁸ Further, if Botetourt Water used the backhoe once a week or one-fifth of the time, then \$400⁹⁹ would be assigned to the Company. The result of the foregoing example can vary depending upon the backhoe's original cost, depreciation period, age, estimated salvage value, method of depreciation, level of non-Botetourt Water use, and the level of Botetourt Water's non-capital related use. Nonetheless, the example illustrates that based on the record in this case, Staff witness Barker's expense adjustment of \$430 is a more reasonable estimate than the \$11,252 amount proposed by Botetourt Water. Consequently, Staff's recommended adjustment should be adopted in this case.

4. Mileage Expense

Again, Botetourt Water failed to include any mileage expense in test year operating expenses. Staff estimated the number of miles driven by the Company's employees to be approximately 1,235 miles, and included a mileage expense of \$383 based on the standard Internal Revenue Service rate of \$0.31 per mile.¹⁰⁰ Company witness Bowen, on rebuttal, argued that the Staff's mileage adjustment understated the actual miles driven by its employees and should be increased to \$3,180.60.

Although the Company failed to keep any mileage logs, Mr. Bowen estimates that Botetourt Water employees drove 10,260 miles during the test year.¹⁰¹ The following table shows the specifics of Mr. Bowen's estimates:¹⁰²

<u>Description</u>	<u>Miles/Trip</u>	<u>Number of Trips</u>	<u>Total Miles</u>
Purchase of supplies	80	104	8,320
Read meters and make bank deposits			480
Check circuit breakers at pump houses	4	365	1,460
Total			<u>10,260</u>

Staff witness Barker defended his estimate of miles traveled by questioning "Mr. Bowen's assertion that 104 trips at 80 miles per trip are necessary to pick up supplies."¹⁰³ Mr. Barker

⁹⁸ \$10,000 divided by 5.

⁹⁹ \$2,000 divided by 5.

¹⁰⁰ Exhibit JBB-S-3, at 13, Appendix A at 19.

¹⁰¹ Exhibit JBB-C-7, at 6.

¹⁰² *Id.* at 6-7.

¹⁰³ Barker, Tr. at 30.

asserts that the Company could eliminate many of its trips with proper planning.¹⁰⁴ Further, because Botetourt Water failed to maintain a mileage log, Mr. Barker recommends that Staff's proposed adjustment be adopted in this case.

During the hearing, Mr. Bowen explained that Botetourt Water purchases supplies as needed -- the Company does not maintain an inventory.¹⁰⁵ During cross-examination, Mr. Bowen provided the following justification for Botetourt Water's apparent inability to anticipate supply needs in advance:

[w]e never know what kind of a breakdown we're going to have, will it be a lightning strike, or will it be a bulldozer mashing ten feet of water line, and what type of repair clamps do we need.¹⁰⁶

As with the issues already discussed, Botetourt Water's failure to maintain proper records limits inquiry into mileage expenses. However, based on the record, Staff's estimate appears to understate the number of miles necessary to operate the system. Staff does not dispute Mr. Bowen's estimates for reading meters, making bank deposits, or checking circuit breakers at pump houses. Thus, at a minimum, the number of miles used to calculate this expense should be increased to 1,940 miles.¹⁰⁷ Moreover, the Staff does not appear to question the need for supplies or that Company employees may devote some of their time to purchasing supplies. In this regard, Mr. Bowen's monthly duties include two hours per month with the following caption:

Make trips to grocery store to purchase chlorox for chlorinators.
Deliver chlorox to both well houses and keep shelves stocked.¹⁰⁸

Staff proposes to include time for Mr. Bowen to purchase supplies, but does not include any mileage related to the purchase of supplies. During cross-examination Mr. Bowen indicated that one source of supplies was located approximately fifteen miles from his home.¹⁰⁹ Thus, I find that at a minimum, the record supports the inclusion of an additional 360 miles for the purchase of supplies, which equates to two thirty-mile trips per month. Therefore, I recommend that Staff's mileage expense be increased to \$713, based on 2,300 of total mileage.

5. Rate Case Expense

Initially, Staff recommended the Company's estimated rate case expense of \$700 be amortized over two years.¹¹⁰ In his rebuttal testimony, Botetourt Water witness Bowen increased

¹⁰⁴ *Id.* at 30, 52.

¹⁰⁵ Bowen, Tr. at 76-77.

¹⁰⁶ *Id.* at 91.

¹⁰⁷ 480 miles to read meters and make bank deposits, plus 1,460 miles to check circuit breakers at pump houses.

¹⁰⁸ Exhibit JBB-S-3, Appendix A at 15.

¹⁰⁹ Bowen, Tr. at 91.

¹¹⁰ Exhibit JBB-S-3, at 7-8.

the Company's estimated cost for this case from \$700 to \$2,700 based on new estimates reflecting that the case would be contested before the Commission.¹¹¹ During the hearing, Staff witness Barker accepted the Company's new estimate, but recommended that the amortization period be changed from two to three years.¹¹² Mr. Bowen did not offer testimony in opposition to a three-year amortization period.

The record indicates that Botetourt Water increased rates without public hearing in 1994 and 1996. The last contested rate case for the Company was in 1992. Thus, based on the Company's history of contested rate cases, I find that Staff's proposal to amortize rate case expense over three years is reasonable and should be adopted.

6. Health Insurance Expense

In his rebuttal testimony, Botetourt Water witness Bowen requested that operating expense be increased by \$1,776 to reflect the costs of health insurance purchased on behalf of Mr. and Mrs. Bowen.¹¹³ Because this adjustment was proposed in rebuttal testimony, Staff did not have an opportunity to verify the cost.¹¹⁴ Therefore, Staff did not support inclusion of this expense in the cost of service.¹¹⁵ However, Staff witness Barker testified that if such an adjustment were made, "an appropriate allocation of this type of expense would be on the number of hours worked annually compared to a full-time position."¹¹⁶

At the Company's request, Exhibit JBB-C-8 was reserved for the late filing of support for Botetourt Water's claimed health insurance. On October 15, 1998, Botetourt Water, by counsel, filed Exhibit JBB-C-8, which consisted of a cover page showing health care costs for 1997 and for the first three quarters of 1998, and additional attached pages providing what appear to be copies of the monthly checks used to pay for the health care costs for Mr. and Mrs. Bowen.¹¹⁷ Exhibit JBB-C-8 supports Mr. Bowen's claim for health care costs of \$296 per month. Therefore, following Staff's proposed allocation methodology, \$738, or approximately 20.77%¹¹⁸ of the total annual health care costs of \$3,552,¹¹⁹ should be added to operating expenses.

Revenue Requirement

¹¹¹ Exhibit JBB-C-7, at 7.

¹¹² Barker, Tr. at 22.

¹¹³ Exhibit JBB-C-7, at 9.

¹¹⁴ Barker, Tr. at 30.

¹¹⁵ *Id.*

¹¹⁶ *Id.*

¹¹⁷ Exhibit JBB-C-8.

¹¹⁸ 20.77% equals 432 hours (for Mrs. Bowen) divided by 2,080. Mrs. Bowen's hours were used for allocation purposes because they were lower than Mr. Bowen's hours and Botetourt Water failed to provide enough detail to assign health care costs between Mr. and Mrs. Bowen.

¹¹⁹ \$3,552 equals \$296 times twelve months.

As shown on the attached schedules, incorporating the above adjustments produces an adjusted operating income of \$5,863 and a rate base of \$36,014. Thus, under current rates, Botetourt Water will earn an overall rate of return on rate base of 16.28%. Initially, Staff found that Botetourt Water required an operating income of \$7,499 and a return on rate base of 21.13%.¹²⁰ However, during the hearing Staff lowered its recommended return to 18.64% on rate base.¹²¹ Botetourt Water did not challenge or object to Staff's revised return recommendation. Accordingly, to achieve Staff's recommended return of 18.64%, the Company's current rates should be increased to produce additional annual revenues of \$870. Following Staff witness Abbott's recommended rate design, the minimum bill should be maintained at \$16.00 with the increase assigned to the usage rate.

Connection Fees

During its review of Botetourt Water, Staff discovered that in 1994 the Company instituted a \$500 connection fee.¹²² In addition, in 1997, Botetourt Water collected \$1,000 in connection fees from each of two new customers located outside its certificated service territory.¹²³ Through the end of 1997, Botetourt Water has collected \$8,970 in connection fees.¹²⁴ Consequently, Staff witness Abbott recommended that the Commission order the Company: (1) to cease charging connection fees and refund all connection fees collected by the Company to the affected customers; and (2) to request an amendment to its certificate of public convenience and necessity to expand its service territory to include all customers and any other areas of possible future expansion. Each of these recommendations will be discussed separately below.

1. Connection Fees

Staff's recommendation regarding connection fees collected beginning in 1994 raises three issues. First, did Botetourt Water have the authority to implement a connection fee in 1994 without approval of the Commission? Second, if Botetourt Water did not have the authority unilaterally to implement a connection fee, is the Company required to refund these amounts? Third, based on the record, should a connection fee, if adopted, become effective with the rates from this case?

Authority to Implement Rates

The Small Water Act requires Botetourt Water to maintain for public inspection during normal business hours in its business office "a copy of its current rates, charges, fees, rules and regulations."¹²⁵ These rates, charges, fees, rules and regulations should include the terms and

¹²⁰ Exhibit JBB-S-3, at 21.

¹²¹ Barker, Tr. at 22, Exhibit JBB-S-4.

¹²² Exhibit GLA-6, at 5.

¹²³ *Id.*

¹²⁴ *Id.* at 6.

¹²⁵ Virginia Code § 56-265.13:5.

conditions, including any connection fees, by which new customers are connected to the Company's system. Furthermore, the Small Water Act permits a utility to change its rates, charges, fees, rules and regulations only by first notifying all of its customers and the Commission. Specifically, § 56-265.13:5 B states:

Unless a small water or sewer utility notifies in writing all of its customers of any changes in its rates, charges, fees, rules and regulations at least forty-five days in advance of any change in any one of them, the utility shall not make any such changes. A copy of such notification shall be forwarded to the Commission at the same time as provided to the customers.

On brief, Botetourt Water argues that failure to provide notice does not prejudice existing customers.¹²⁶ According to the Company, "notice of changes must be provided only to customers of the utility" that are already connected to the system.¹²⁷ Thus, any failure to provide notice of the institution of a new connection charge for new customers does not prejudice existing customers. But, Botetourt Water's premise that notice is given only to existing customers is incorrect. As shown above, the statute also requires prior notice to the Commission. Such notice provides the Commission with an opportunity to examine proposed tariff changes on behalf of potential future customers or the public. Indeed, Botetourt Water's point that existing customers may not be affected by a proposed change in rates illustrates the importance of providing prior notice to the Commission. Accordingly, I find that Botetourt Water did not provide notice as prescribed by § 56-265.13:5 B and, therefore, did not have the authority to implement a connection charge in 1994.

Remedy for Unauthorized Charge

Botetourt Water maintains that even if it lacked the authority to implement a connection charge in 1994, "[i]t would be inequitable to penalize the customers connected to the water system prior to 1993 by requiring the utility to refund connection fees collected from 1993 through 1997."¹²⁸ Because all connections prior to 1994 were contributed, the costs of connections prior to 1994 are excluded from the Company's cost of service. Connections beginning in 1994 were not contributed to the Company. If Botetourt Water is ordered to refund all connection fees, then the cost of service for all customers will include costs related to connections made subsequent to 1993. Thus, the Company contends that such a refund would cause customers existing prior to 1994 to subsidize customers added after that date.

I disagree. That the cost of service for all customers includes costs related to adding a few new customers does not automatically create a subsidy nor is it inequitable. Increasing the base of customers may reduce the overall level of cost of service assigned to individual customers. While it may be more preferable to assign cost directly to those who cause a cost to be incurred

¹²⁶ Botetourt Water Brief at 4.

¹²⁷ *Id.*

¹²⁸ *Id.* at 5.

through a properly devised connection fee, arguments of possible subsidy cannot and should not alter the statutory and regulatory requirements and procedures designed to protect all customers, including potential future customers.

The Company further insists that a refund of connection fees collected since 1994, will create a disparity between customers added before and after 1994 in violation of the mandate of § 56-265.13:4 that charges be “uniform as to all persons or corporations using such service under like conditions.”¹²⁹ However, just the opposite is true. If refunds are not made, then some new customers will have been added to the system without having been required to pay a connection fee in accordance with the Company’s approved tariff, while other new customers will have been added to the system only after having paid a connection fee in violation of the Company’s approved tariff. In other words, “uniformity” requires that all customers be charged in accordance with the Company’s approved tariff.

In its brief, the Staff supports its recommendation that Botetourt Water refund all connection fees collected contrary to its filed tariff based on the “filed rate doctrine.”¹³⁰ Under the “filed rate doctrine” it is unlawful for a utility to charge rates other than what is explicit in its published tariff on file with the Commission.¹³¹ Staff cites to several statutes and cases to demonstrate that the “filed rate doctrine” is well established in Virginia and is necessary for the protection of the consuming public.¹³²

Based on the record in this case, I agree with Staff that Botetourt Water should be ordered to refund all connection fees collected prior to interim rates going into effect subject to refund or, March 5, 1998. Any result other than a refund would permit the Company an unauthorized change in tariff. Put simply, refunding all connection fees collected prior to March 5, 1998, places Botetourt Water and its customers in the same position in which they would have been had the Company followed its tariff. Any unauthorized connection fees collected by Botetourt Water, plus interest, should be refunded to the customer who paid the fees over a three-year period, in three annual installments.

Adoption of a Connection Fee

Furthermore, I find that Botetourt Water has provided adequate support for the institution of a connection fee of \$500.00 or actual cost, whichever is greater.¹³³ Because the record supports the institution of a connection fee with the rates established in this case, the cut-off-date for refunds of unauthorized connections fees should be March 5, 1998, which is the date interim rates from this case became effective, subject to refund. Moreover, the Commission in its March 18, 1998 Order for Notice and Hearing in this case, directed the Company to provide notice to each of its customers:

¹²⁹ *Id.* at 2;

¹³⁰ Staff Brief at 7-10.

¹³¹ *Id.* at 7.

¹³² *Id.* at 7-10.

¹³³ *See*, Exhibit JBB-C-7, Attachment B; Exhibit JBB-C-9.

While the total revenue that may be approved by the Commission is limited to the amount produced by the Company's proposed rates, PLEASE TAKE NOTICE that the individual rates and charges approved may be either higher than or lower than those proposed by the Company.

By complying with the above directive, Botetourt Water satisfied the notice requirements of Virginia Code § 56-265.13:5 B as to rates that may be adopted in this case. Thus, the Commission may adopt a higher connection fee than originally requested by the Company so long as overall revenues produced fall below Botetourt Water's original requested increase of \$3,313.¹³⁴ As discussed earlier, I find and recommend that Botetourt Water's requested annual increase be reduced to \$870. Based on an average of four new connections per year,¹³⁵ the recommended connection fees should produce approximately \$2,000 in additional revenues.

Finally, because some of the data supporting the adoption of a connection fee in this case was filed via a late-filed exhibit reserved during the hearing, Staff should be directed to re-examine Botetourt Water's connection fees in the Company's next case.

2. Certificate of Public Convenience and Necessity

During its investigation, Staff discovered that Botetourt Water extended its system to provide service to two customers outside its certificated service territory. On rebuttal, the Company admitted that it "should have requested an increase in the utility's service territory."¹³⁶ The Small Water Act specifically provides that utilities subject to the Small Water Act remain subject to the Utility Facilities Act codified as Chapter 10.1 to Title 56 of the Virginia Code.¹³⁷ The Utility Facilities Act requires prior notice for any changes in a utility's certificated service territory.¹³⁸ Prior notice also is required before a utility may make an "ordinary extension or improvement outside of the territory in which the public utility is lawfully authorized to operate."¹³⁹ While it may be expedient to amend the Company's certificate in this proceeding, because Botetourt Water has failed to provide prior notice as required by the Utility Facilities Act, its certificated service territory cannot be amended in this proceeding. Therefore, Botetourt Water should be directed to file the prescribed notice and comply with the Utility Facilities Act as soon as possible.

FINDINGS AND RECOMMENDATIONS

¹³⁴ Exhibit JBB-S-3, Appendix at 2.

¹³⁵ Barker, Tr. at 28.

¹³⁶ Exhibit JBB-C-7, at 8.

¹³⁷ Virginia Code § 56-265.13:7.

¹³⁸ Virginia Code § 56-265.3.

¹³⁹ Virginia Code § 56-265.2 C.

In conclusion, based on the evidence received in this case, I find that:

- (1) The use of a test year ending December 31, 1997, is proper in this proceeding;
- (2) The Company's test year operating revenues, after all adjustments, were \$48,504;
- (3) The Company's test year operating revenue deductions, after all adjustments, were \$42,641;
- (4) The Company's test year net operating loss and adjusted net operating income, after all adjustments were \$(16,439) and \$5,863, respectively;
- (5) The Company's current rates produce a return of 16.28%;
- (6) The Company's current cost of capital, upon which its rates should be established, is 18.64%;
- (7) The Company's adjusted test year rate base is \$36,014;
- (8) The Company's application requesting an annual increase in revenues of approximately \$3,313 is unjust and unreasonable because it will generate a return on rate base greater than 18.64%;
- (9) The Company requires \$870 in additional gross annual revenues to earn an 18.64% return on rate base;
- (10) The Company's existing rate structure should be maintained. The monthly rate for the first 2,000 gallons of usage should remain at \$16.00. The annual increase of \$870 should be added to the consumption charge for monthly usage in excess of 2,000 gallons, which currently is \$5.00 per thousand gallons;
- (11) The Company should institute a connection fee for the installation of new connections of \$500.00 or actual cost, whichever is greater. The Company should begin collecting these fees as of March 5, 1998, the date rates from this case were permitted to take effect, subject to refund;
- (12) In its next case, the Company shall file cost information in support of its connection fee;
- (13) The Company should file permanent rates designed to produce the additional revenues found reasonable herein using the revenue apportionment methodology proposed by the Staff and described above;
- (14) The Company should be required to refund, with interest, all revenues collected under its interim rates in excess of the amount found just and reasonable herein;

(15) The Company also should be required to refund, with interest, all connection fees collected prior to March 5, 1998, over three years, in three annual installments; and

(16) The Company forthwith shall provide proper notice and submit a proper filing with the Commission seeking approval to serve customers outside its currently certificated service territory.

I therefore **RECOMMEND** that the Commission enter an order that:

- (1) **ADOPTS** the findings in this Report;
- (2) **GRANTS** the Company an increase in gross annual revenues of \$870; and
- (3) **DISMISSES** this case from the Commission's docket of active cases and passes the papers herein to the file for ended causes.

COMMENTS

The parties are advised that any comments (Rule 5:15(e)) to this Report must be filed with the Clerk of the Commission in writing, in an original and fifteen (15) copies, within fifteen (15) days from the date hereof. The mailing address to which any such filing must be sent is Document Control Center, P. O. Box 2118, Richmond, Virginia 23216. Any party filing such comments shall attach a certificate to the foot of such document that copies have been mailed or delivered to all other counsel of record and to any party not represented by counsel.

Respectfully submitted,

Alexander F. Skirpan, Jr.
Hearing Examiner